87-1568

NO. __

Supreme Court, U.S.
FILED
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JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court Of The United States

October Term 1987

ALLEN TRANSFORMER COMPANY . . *Petitioner*

v.

CHARLES D. RAGLAND,
COMMISSIONER OF REVENUES
FOR THE STATE OF ARKANSAS . . . . *Respondent*

ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF ARKANSAS

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ARKANSAS

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QUESTIONS PRESENTED FOR REVIEW

1. The Arkansas Gross Receipts Tax as applied to services performed on out-of-state property brought into the State of Arkansas places a burden on interstate commerce violative of the interstate commerce clause of the United States Constitution.

2. The Arkansas Gross Receipts Tax System violates Petitioner's constitutional guaranty of equal protection by exempting from the tax certain services performed in state on out-of-state property while taxing similar services performed by Petitioner in the State of Arkansas on out-of-state property.

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ALLEN TRANSFORMER COMPANY . . Petitioner

v.

CHARLES D. RAGLAND,
COMMISSIONER OF REVENUES
FOR THE STATE OF ARKANSAS . . . Respondent

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ARKANSAS

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Allen Transformer Company, an Arkansas Corporation (hereinafter the "Petitioner") respectfully prays that a Writ of Certiorari issue to review the judgment of the Supreme Court of the State of Arkansas reversing the judgment entered in favor of the Petitioner by the Chancery Court of Sebastian County, Arkansas (Langston, J.).

OPINION BELOW

The published opinion of the Supreme Court of Arkansas reversing the judgment of the Chancery Court of Sebastian County, Arkansas appears at Appendix 1. *Charles D. Ragland, Commissioner of Revenues v. Allen Transformer Company*, 293 Ark. 601, __ S.W.2d __ (1987)

JURISDICTION

On November 23, 1987, the Supreme Court of the State of Arkansas entered its decision reversing the judgment of the Chancery Court of Sebastian County, Arkansas. On December 21, 1987, the Supreme Court of the State of Arkansas entered its order denying the Petitioner's Motion for a Rehearing. A copy of the order denying the Motion for Rehearing appears at Appendix 10. This Court's jurisdiction is invoked under Title 28 United States Code §1257(3).

CONSTITUTIONAL PROVISIONS INVOLVED

The United States Constitution Article I. Section 8, cl.3:

to regulate commerce with foreign nations and among the several states, and with the Indian tribes.

The United States Constitution Amendment XIV:

(The pertinent part provides)
. . . nor shall any state . . . deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

The Petitioner is an Arkansas Corporation located in Fort Smith, Arkansas, engaged in the business of repairing, rewinding, rebuilding and remanufacturing electrical transformers used primarily by public utilities. The Respondent conducted a sales tax audit of the Petitioner's records for the audit period of April 1, 1977 through March 31, 1983. The audit resulted in an assessment of additional tax, interest and penalty of Thirty-nine Thousand Three

Hundred Sixty-one and 18/100 ($39,361.18) Dollars. This assessment was based upon repair services performed by the Petitioner at its location in Fort Smith, Arkansas on property shipped into the State of Arkansas by out-of-state companies for repair. After completing the prescribed repairs on the transformers, the transformers were returned to the out-of-state company.

Evidence presented at trial pointed out that one of the Petitioner's primary customers, Oklahoma Gas and Electric Company, domiciled in Oklahoma City, Oklahoma, refused to pay the Arkansas sales tax deducing that instead of a sales tax, the transaction between Oklahoma Gas and Electric Company and the Petitioner resulted in a compensating use tax liability to the State of Oklahoma and thus, payment of the Arkansas Gross Receipts Tax for the transaction would result in a double taxation on the transaction. Similar testimony was presented with regard to the application of the Missouri compensating use tax as it applied to the Petitioner's customer, Empire Electric District. The evidence at trial reflected that the Missouri taxing authorities had taken the position that the transaction was one of interstate commerce and thus resulted in a compensating use tax liability on the value of the material added to the repaired and remanufactured transformer.

Further, the testimony of the president of the Petitioner reflected the difficulty of soliciting out-of-state business for the reason that the additional Arkansas Gross Receipts Tax would have to be applied to the cost of the service while at the same time, the out-of-state company would likewise be paying their own state's compensating use tax.

The Arkansas Sales Tax scheme provides for the taxation of services on sales which occur in the State of Arkansas. In addition to delineating the services which are taxed, the Act also provides for exemption of certain types of services performed in the State of Arkansas on out-of-state property. Specifically, the Act excludes from the tax, the repair or maintenance of railroad parts, railroad cars and equipment brought into the state for such repair; the repair of watches and clocks which are received by mail or common carrier from outside the state; and, the in-state repair and refurbishing services performed on telephone instruments.

The parties stipulated as to each out-of-state invoice for which the Respondent was requesting the collection of the Arkansas Gross Receipts Tax on out-of-state property brought into Arkansas for repair. The evidence reflected that the Petitioner did not collect the tax from the out-of-state company.

REASONS FOR GRANTING THE WRIT

A.

The Arkansas Gross Receipts Tax as applied to services performed on out-of-state property brought into the State of Arkansas places a burden on interstate commerce violative of the Interstate Commerce Clause of the United States Constitution.

The application of the Arkansas Gross Receipts Tax to the services performed on property brought into the State of Arkansas, places a burden on interstate commerce. The Arkansas Revenue Department has chosen to apply the tax at the point of sale as a sales tax rather than a compensating use tax. This has created a double taxation problem for those companies which do business in Arkansas while at the same time they are forced to pay a compensating use tax by the state in which they are domiciled. This has a result of discouraging companies who are domiciled outside the State of Arkansas from sending property into the State of Arkansas for repair knowing that they will pay two taxes on the same transaction. First, they will pay the Arkansas Gross Receipts Tax on the services performed in Arkansas and second, they will pay their state use tax on the added value as a result of the repair. This would not have occurred had the property been repaired in the

state of the company's domicile rather than shipping it into the State of Arkansas. The net result is to place a burden on Arkansas businesses attempting to do business in interstate commerce and a burden on those companies needing the services provided by Arkansas companies.

Previous decisions of this Court reflect the underlying philosophy that interstate commerce should enjoy immunity from state taxation. *Spector Motor Service v. O'Conner,* 340 U.S. 602, 95 L.Ed 573, 71 S.Ct. 508 (1951); *Freeman v. Hewit,* 329 U.S. 249, 91 L.Ed 265, 67 S.Ct. 274 (1946). Assuming the principles outlined in *Spector Motor Service* and *Freeman* were still applicable today, the situation which has arisen by the Petitioner's attempt to do business in interstate commerce would be easily answered. The states contiguous to Arkansas would charge to the company domiciled in their state a compensating use tax for the material or equipment sent out of state to be repaired. There would not be an application of the Arkansas Gross Receipts Tax (sales tax) to the transaction because the transaction is one of interstate commerce.

However, applying the decision of *Complete Auto Transit v. Brady,* 430 U.S. 274, 51 L.Ed 2d 326, 97 S.Ct. 1076 (1977), a double taxation problem arises. In applying the four-prong test announced in *Complete Auto Transit,* not only would the Arkansas

Gross Receipts Tax Act be applicable, but also, the compensating use tax of each state shipping out property to be repaired for the reason that each state believes that it has a reasonable connection to the transaction to justify a tax.

This presents a question as to whether or not a more detailed analysis of the four-prong approach of *Complete Auto Transit* is applicable or whether the *Complete Auto Transit* approach should be discarded.

In determining whether or not there is a substantial nexus with the state seeking to apply the tax, the Court must decide whether there is a connection between the state and the person and/or entity it seeks to tax. The Court should note that the Petitioner in this case is not the taxpayer as such, but rather only the collector of the tax for the Respondent. The ultimate taxpayer is the non-resident company such as Oklahoma Gas and Electric or Empire Electric Company of Missouri or such other public utility located outside the State of Arkansas shipping equipment into the State of Arkansas for repair. Therefore, the nexus between the State of Arkansas and the activity need not necessarily be between the Petitioner and the State of Arkansas, but rather the ultimate taxpayer and the State of Arkansas. Administratively, if each state simply applied their compensating use tax to

interstate commerce transactions, such as the transaction involving the Petitioner, there would not be a problem focusing on who the ultimate taxpayer is. Further, the Petitioner as the tax collector for the Respondent finds itself in a position of collecting taxes in multiple states where they must face opposition from companies who are obligated to pay the compensating use tax of their domicile state. The evidence in this case presented at trial clearly reflects that the Petitioner's out-of-state customers such as Oklahoma Gas and Electric or Empire Electric of Missouri take the position that the service provided adds value to the equipment serviced by the Petitioner and that this added value results in a compensating use tax which is owed to their respective states. Applying a state's compensating use tax for the purpose of collecting tax on a transaction of the nature involved in this case, the nexus could easily be determined to be the domicile of the company who is the ultimate taxpayer or rather the state where the property finally comes to rest.

Even after considering the issue of whether or not there is a substantial nexus with the state applying the tax, the remaining elements of the *Complete Auto Transit* case must be applied. Under the Arkansas Gross Receipts Tax Scheme, other businesses in Arkansas where out-of-state property is brought in-state for repair or refurbishing, are permitted exemptions under the Arkansas code. In

Ark. Code Ann. §26-52-301, it is provided:

> . . . provided, however, that the Gross Receipts Tax levied in this act [Ark. Stat. Ann. §84-1903 (c) (3)] shall not apply to the repair or maintenance of railroad parts, railroad cars and equipment brought into the State of Arkansas solely and exclusively for the purpose of being repaired, refurbished, remodified or converted within the state.

Further, Act 471 of 1981 [Ark. Stat. Ann. §84-1903.4] and Act 495 of 1985 [Ark. Stat. Ann. §84-1903.6] permit exemptions to the repair and services performed within the State of Arkansas on watches, clocks and telephone equipment received from customers located outside Arkansas. It is clear on the face of the statute that the Arkansas Gross Receipts Tax Act is not fairly apportioned among all taxpayers who do business in interstate commerce.

Further, the four-prong test in *Complete Auto Transit* requires analysis to determine whether or not the tax is discriminatory against interstate commerce. The evidence presented at trial by the Petitioner clearly indicated that the adding of the Arkansas Gross Receipts Tax to the invoice made it difficult for the Petitioner to compete actively for the business of public utilities outside the State of

Arkansas where those utilities paid a compensating use tax in the state of their domicile. The result obviously, is that for those companies domiciled outside the State of Arkansas to do business with an Arkansas company, they must be willing to pay a higher price for the service.

The Petitioner contends that the application of the four-prong test pronounced in *Complete Auto Transit* gives rise to the possibility that any tax enacted by a state where there may be some contact with that state could be a constitutional tax. The true effect is that applying this test places companies in the position of paying a tax more than once on the same transaction where that transaction may have contact with more than one state, thus resulting in a burden on interstate commerce which has an effect of discouraging companies from looking outside their state's borders to do business.

In *American Trucking Association v. Cheiner,* 483 U.S. __, 97 L. Ed 2d 226, 107 S.Ct. __ (1987), the Court found that a Pennsylvania tax was unconstitutional for the reason that the methods by which they were assessed were discriminatory against interstate commerce in a way that contradicts the commerce clause central purpose of guaranteeing a free trade area among states. This same argument can be made in the case at hand in that the application of the

multiple taxing schemes of the various states to interstate commerce transactions disrupts interstate commerce in a way that discourages free trade among the states. By allowing each state to apply a tax to a transaction, whether it be a use tax and/or sales tax without a compensating credit for the payment of a tax in another state disrupts trade among the states. In the case of the Arkansas Gross Receipts Tax Act, there is no compensating credit for the payment of the contiguous state use tax. The application of the Arkansas Gross Receipts Tax to the Petitioner's out-of-state transactions does not maintain the state boundary as a neutral factor.

The question of free trade among the states has become even more confusing among the states surrounding the State of Arkansas by the Tennessee case of *Le Tourneau Sales and Service, Inc. v. Olsen*, 691 S.E.2d 531 (1985). The Tennessee court like the Arkansas Supreme Court approved the application of the Tennessee Sales Tax on services performed within the state when electric motors were shipped into Tennessee. The Tennessee court found there was a substantial connection with the state which would allow the imposition of the sales tax. As stated above, the application of *Complete Auto Transit* nexus test permits any state with a connection to apply a tax.

B.

The Arkansas Gross Receipts Tax System violates Petitioner's constitutional guaranty of equal protection by exempting from the tax certain services performed in state on out-of-state property while taxing similar services performed by Petitioner in the State of Arkansas on out-of-state property.

The Arkansas Gross Receipts Tax Act is codified at Ark. Code Ann. §26-52-101 et seq. The pertinent provisions applicable here are set forth in Ark. Code Ann. §26-52-301, which reads as follows:

Tax Levied. There is levied an excise tax of three percent (3%) upon gross proceeds or gross receipts derived from all sales to any person of the following:

(1) Tangible personal property;

(2) Natural or artificial gas, electricity, water, ice, steam or any other utility or public service except transportation services, sewer services and sanitation or garbage collection services;

(3)(A) Service by telephone, telecommunications, and telegraph companies to subscribers or users, including transmission of messages or images, whether local or long distance. This shall include all

service and rental charges having any connection with transmission of any message.

(B) Service of furnishing rooms by hotels, apartment hotels, lodging houses and tourist camps or courts to transient guests; the term 'transient guests' being defined for the purpose hereof as those who rent accommodations other than their regular place of abode on less than a month-to-month basis.

(C)(i) Service or alteration, addition, cleaning, refinishing, replacement, and repair of motor vehicles, aircraft, farm machinery and implements, motors of all kinds, tires and batteries, boats, electrical appliances and devices, furniture, rugs, upholstery, household appliances, television and radio, jewelry, watches and clocks, engineering instruments, medical and surgical instruments, machinery of all kinds, bicycles, office machines and equipment, shoes, tin and sheetmetal, mechanical tools, and shop equipment.

(ii) However, the provisions of this section shall not apply to coin-operated car washes. For the purpose of this section, a coin-operated car wash shall be defined as one wherein the car washing equipment is activated by the insertion of coins into a slot or receptacle and where the labor of washing the exterior of the car or motor vehicle is performed solely by the customer or by mechanical equipment.

(iii) Additionally, the gross receipts tax levied in this section shall not apply to the repair or maintenance of railroad parts, railroad cars, and equipment brought into the State of Arkansas solely and exclusively for the purpose of being repaired, refurbished, modified, or converted within this state.

(iv) The General Assembly determines and affirms that the original intent of this subdivision which provides that gross receipts derived from certain services would be subject to the gross receipts tax was not intended to be applicable, nor shall the Arkansas gross receipts taxes be collected, with respect to services performed on watches and clocks which are received by mail or common carrier from outside this state and which, after the service is performed, are returned by mail or common carrier or in the repairman's own conveyance to points outside this state;

(4) Printing of all kinds, types, and characters, including the service of overprinting, and photography of all kinds.

(5) Tickets or admissions to places of amusement; to athletic, entertainment, or recreational events; or fees for the privilege of having access to or the use of amusement, entertainment, athletic, or recreational facilities including free or complimentary passes and

tickets, admissions, dues, or fees, with such free or complimentary passes, tickets, dues, or fees being declared to have a value equivalent to the sale price of tickets, passes, admissions, fees, or dues of like kind or character.

The Arkansas Act provides for the taxing of services while at the same time, permits certain types of transactions whereby out-of-state property brought in-state for repair to be exempted from the tax. In reviewing the preamble of the act as well as the legislative history, there does not appear to be any rational basis for the permitted exemptions. In fact, the distinctions between the services taxed and the exempt services bears no relationship to a legitimate state purpose such as raising revenue, or protecting the public interest. It certainly cannot be rationally argued that the purpose of the exemption is to promote employment within the State of Arkansas, while, at the same time, taxing other companies who likewise provide services on out-of-state property and provide employment in the State of Arkansas.

On its face, the Arkansas Statute appears to permit such exemptions on a favored basis for particular industries and more likely the granting of the exemption by the state legislature relates more to the ability of the lobbyist than the furtherance of any

legitimate state purpose.

The Court in *Williams v. Vermont*, 472 U.S. 14, 86 L.Ed 2d 11, 105 S.Ct. 2465 (1985) held that the taxpayers stated an equal protection claim because the statute, on its face, created a "wholly arbitrary" distinction. The distinction in *Williams* was between non-resident and resident taxpayers which granted Vermont residents a credit for the sales tax paid to reciprocating states on cars purchased out of state. However, the state did not grant the same credit to non-residents who had registered their cars in other states before moving to Vermont.

The same argument can be made regarding the exemptions granted under the Arkansas Sales Tax Scheme except that, instead of applying a distinction between non-residents and residents, the distinction is based on the type of property being brought into the state for repair. Of the items exempted under the Arkansas Tax Scheme, one can readily ascertain that the statute on its face fails to provide a rational basis for promoting any legitimate state interest not otherwise promoted in a similar fashion by those companies subjected to the tax by providing services on out-of-state property shipped in-state.

The Court on two occasions has had the opportunity to review state taxing schemes which

provide exemptions to particular products or services under a sales or use tax statute.

In *Minneapolis Star and Tribune Company v. Minnesota Commissioner of Revenues*, 460 U.S. 575, 75 L.Ed 2d 295, 103 S.Ct. 1356 (1983), and *Arkansas Writers Project, Inc. v. Ragland, the Commissioner of Revenues of Arkansas*, 481 U.S. __, 95 L.Ed 2d 205, 107 S.Ct. 1722 (1987), the Court had the opportunity to review each case on an equal protection basis. However, in that both *Minneapolis Star and Tribune Company* and *Arkansas Writers Project, Inc.*, involved questions dealing with first amendment rights, the Court was able to dispose of these cases by applying the strict scrutiny test in that each case involved a fundamental right. The case now before the Court does not involve a fundamental right but still, involves the granting of exemptions on an arbitrary basis by type of product and directly favors those companies manufacturing the products without promoting any legitimate state purpose. It is the position of the Petitioner that a more vigorous test be applied to the granting of these exemptions rather than a simple rational basis review which has been applied in the past. Petitioner contends that if the Court applies a similar standard to that applied in *Williams*, the Court would reach a result that the granting of exemptions under the Arkansas Gross Receipts Tax Scheme is wholly arbitrary and without any legitimate public purpose.

CONCLUSION

Wherefore, for the foregoing reasons, a Writ of Certiorari should issue to review the decision of the Supreme Court of the State of Arkansas and consequently reverse the decision and remand these proceedings for further consideration, as justice may require.

Respectfully submitted,

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Appendix

SUPREME COURT OF ARKANSAS
No. 87-175

Opinion Delivered Nov. 23, 1987

Charles D. Ragland,
Commissioner of Revenues
For the State of Arkansas,
Appellant

v.

Allen Transformer Company,
Appellee

Appeal from the Chancery Court
Of Sebastian County, Arkansas
No. E 86-24
Honorable Don Langston

Reversed and Remanded

This appeal involves the appellant's assessment of a sales tax on repair services performed on electrical transformers by the appellee at its business location in Fort Smith, Arkansas. After exhausting its administrative remedies, appellee filed suit in chancery court, alleging the appellant's assessment was an illegal exaction. The chancellor upheld the appellant's sales tax assessment on the repairs performed for Arkansas customers, but disallowed as

an illegal exaction the assessment on repair services performed within the state on transformers owned by out-of-state customers. The chancellor also awarded appellee attorney's fees. Both parties appeal from the chancellor's decree.

The facts are undisputed. Appellee is in the business of repairing, rewinding and remanufacturing electrical transformers, and while all its repair services are performed in Arkansas, appellee's customers are both within and outside the state. In either case, appellee sends its own truck to pick up the customer's burned out transformer, takes the unit to appellee's business location in Fort Smith for the required repairs and, again by truck, returns the transformer to the customer. As a result of appellant's sales tax audit of appellee's records during the period of April 1977 through March 1983, appellee was assessed an additional tax, interest and penalty of $39,361.18.

Appellant first argues the chancellor erred in determining that no taxable sale occurred on services appellee rendered in the state for its out-of-state customers. In reaching his decision, the chancellor reasoned that before a taxable service can exist, Ark. Stat. Ann. §84-1902(c) (Repl. 1980) requires that the transfer of title or possession of the customer's transformer must occur within Arkansas. Based upon this same reasoning, the chancellor upheld

appellant's assessment of sales tax upon the repairs appellee performed for its Arkansas customers. Thus, the questions posed by appellant's argument is whether the sales tax can be imposed on services performed on electrical devices when the repairs are performed in the state, but the transfer of possession of the device to appellee actually takes place outside the state. We hold it can, and, therefore, must reverse the trial court's holding to the contrary.

Arkansas imposes a three percent tax upon the gross proceeds or receipts derived from all sales listed in Ark. Stat. Ann. §84-1903 (Repl. 1980 and Supp. 1985), and, under subsection (c)(3) of that statute, the tax is levied on, among other things, the service of alteration and repair of electrical appliances and devices. Under Ark. Stat. Ann. §84-1902(c), the term "sale," in pertinent part, is defined to mean the transfer of either title or possession for a valuable consideration of tangible personal property, regardless of the manner, method, instrumentality, or device by which such transfer is accomplished. Appellee's argument, adopted by the chancellor below, is that because appellee picked up and delivered the transformers owned by out-of-state customers at the customers' business locations, no sale, i.e. transfer of possession, occurred within the state pursuant to § §84-1902(c) and -1903(c) to make these transactions taxable. To support its argument, appellee cites the case of *Gaddy v. DLM, Inc.*, 271

Ark. 311, 609 S.W.2d 6 (1980), a case we find unpersuasive because it involved the sale of tangible personal property and did not concern a service, as is the situation here.

In considering the proper construction to be given §§84-1902(c) and -1903(c), as those provisions pertain to the assessment of taxes on services, it is this court's duty to look to the whole act and, as far as practicable, to reconcile the different provisions to make them consistent, harmonious and sensible. *Ragland v. Alpha Aviation, Inc.*, 285 Ark. 182, 686 S.W.2d 391 (1985). We must also decline an interpretation that results in absurdity or injustice, leads to contradiction or defeats the plain purpose of the law. *Id.*, 285 Ark. at 185; 686 S.W.2d at 392. Towards these ends, we first look at §84-1902(c), the provision which defines "sale." In doing so, we find the last sentence of that subsection excludes the furnishing or rendering of services from the definition of sale. As a result, the general assembly obviously intended, under these circumstances, that the transfer of title or possession requirement must occur in the sale of tangible property before the tax is imposed; it provided no such requirement when imposing the tax on services. Other reasons support this interpretation, as well.

For example, the general assembly, in three instances, has deemed it necessary to exempt from

the gross receipts tax certain services performed in-state on out-of-state property. In 1981, it excluded from the tax the repair or maintenance of railroad parts, railroad cars and equipment brought into the state for such repair. *See* Ark. Stat. Ann. §84-1903(c)(3) (Supp. 1985), as amended by Act 983 of 1981. That same year, the general assembly also provided that the gross receipts tax would not apply to in-state services performed on watches and clocks which are received by mail or common carrier from outside the state and which, after the service is performed, are returned in the same manner, or in the repairman's own conveyance, to points outside the state. *See* Ark. Stat. Ann. §84-1903.4 (Supp. 1985). And, finally, the general assembly in 1985, provided an exemption (until July 1, 1987) for in-state repair or refurbishing services performed on telephone instruments that are sent into this state, and, after such repairs or refurbishing, are shipped back to the state of origin. *See* Ark. Stat. Ann. §84-1903.6 (Supp. 1985). Unquestionably, the general assembly, in providing for these special exemptions on specified equipment or devices brought into state for repairs, obviously understood and intended Arkansas's sales tax, levied under §84-1903(c)(3), to cover services performed within the state for both in-state and out-of-state customers.

Appellant underscores another compelling reason why Arkansas's gross receipts law must be

construed in this fashion by pointing to the absurdities that could result if that law were read to allow the imposition of tax on services only when a transfer of possession occurs within the state. To illustrate, under appellee's rationale and the trial court's holding, the repair of a television could be taxable only if the owner surrendered title to or possession of his set. Thus, if the repairman picks up the set and repairs it at the shop, the sales tax would apply; if he repaired it at the customer's house, no transfer would occur, so no tax would attach. The same rationale would extend to other type services or repairs, as well. In the same vein, we need only look to this court's decision in *Department of Finance and Administration v. Otis Elevator Co.*, 271 Ark. 442, 609 S.W.2d 41 (1980), wherein we upheld the state's assessment of sales tax on services performed on elevators when, clearly, no transfer of title or possession occurred. We conclude, in harmonizing and reconciling our sales tax provisions dealing with services and repairs performed within the state, the appellant's assessment of a sales tax on services performed for both in-state and out-of-state customers of appellees was correct.

Next, we turn to appellee's arguments that Arkansas's Gross Receipts Act is ambiguous, vague and violates appellee's rights to due process and equal protection. Appellee, consistent with its earlier contention, argues that, at best, uncertainty exists

under the act as to whether a sales tax should be assessed on transactions involving its out-of-state customers. Referring to *Wiseman v. Arkansas Utilities Co.*, 191 Ark. 854, 88 S.W.2d 81 (1935), it urges that a tax cannot be imposed except by express words indicating that purpose, and that any ambiguity in the act must be resolved in appellee's favor. Appellee further argues an earlier audit performed on its records in 1971 reflects no assessment on out-of-state transactions and it was provided no notice of appellant's later position to assess such transactions although the tax laws were the same at the time the 1971 audit and the one in issue here were performed.

In response to appellee's concerns, we simply cannot agree that §84-1903(c)(3) is in any way vague in its levy of taxes upon the services provided by appellee. Even appellee concedes that the transformers are electrical devices covered under §84-1903(c)(3) and, as such, the repairs of the transformers are subject to the sales tax. Contrary to appellee's assertion, we simply disagree that the tax law is vague in its levy of taxes on appellee's out-of-state customers. Nor do we agree that the appellant's prior audit could have reasonably misled appellee into the belief that its out-of-state transactions would not be assessed. We have carefully reviewed appellee's exhibit #5, which it argues reflects a tax was not assessed on five out-of-state

customers; we find the five transactions to which appellee refers bear changes in each instance to reflect Arkansas addresses. In short, the exhibit provides no real insight concerning whether the transactions occurred in state or out.

Finally, appellee attacks the assessment as a violation of the interstate commerce clause, saying all the sales occurred outside the State of Arkansas, and to tax those transactions would have a chilling effect on its ability to do business with out-of-state customers. We find no merit in appellee's argument. In *Evco v. Jones*, 409 U.S. 91 (1972), the Supreme Court, citing its earlier holding in *Department of Treasury v. Ingram-Richardson Mfg. Co.*, 313 U.S. 252 (1941), reiterated the rule that a state may tax the proceeds from services performed in the taxing state, even though they are sold to purchasers in another state. The *Evco* decision was relied on by the Tennessee Supreme Court in its recent decision in *Le Tourneau Sales and Service, Inc., v. Olsen*, 691 S.E.2d 531 (Tenn. 1985). In rejecting there the same interstate commerce clause argument as is now made here, the Tennessee court upheld the imposition of sales taxes on services performed within the state when motors were shipped into Tennessee, where they were rebuilt, and then returned to the out-of-state customer. As was the situation in *Olsen*, the taxable event involved here is the rendering of services within the state, and a substantial

connection with this state exists to justify the imposition of the sales tax on repair work performed by the appellee in Arkansas.

Consistent with the foregoing reasons, we reverse and remand this cause. In doing so, we need not reach appellant's challenge of the trial court's award of attorney's fees to the appellee as the prevailing party below, except to state that award, too, is reversed upon remand of this cause.

OFFICE OF THE CLERK
SUPREME COURT
OF THE STATE OF ARKANSAS

December 21, 1987

John D. Alford
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Re: 87-175 Charles D. Ragland, Commissioner of Revenues v. Allen Transformer Company

Dear Mr. Alford:

The Court made the following order in the above styled case today:

"Petition for Rehearing is denied."

Sincerely yours,
LESLIE W. STEEN, Clerk

(2)

Supreme Court, U.S.
FILED
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CLERK

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ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF ARKANSAS

RESPONSE OPPOSING PETITION
FOR WRIT OF CERTIORARI
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RESPONSE OPPOSING PETITION
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TO THE SUPREME COURT OF ARKANSAS

STATEMENT OF THE CASE

The Respondent, Charles D. Ragland, Commissioner of Revenues for the State of Arkansas, is responsible for the administration of the Arkansas Gross Receipts (Sales) Tax. The Petitioner, is an Arkansas Corportion engaged in the business of repairing, rewinding and remanufacturing electrical transformers at its location in Fort Smith, Arkansas. The Commissioner audited Petitioner for sales tax for the period April 1, 1977 through March 31, 1983, resulting in an assessment of additional tax, interest and penalty in the amount of $39,361.18. The additional sales tax was assessed on sales of repair services performed by Petitioner at Fort Smith, Arkansas on property which had been shipped into Arkansas from out-of-state by customers located outside Arkansas.

SUMMARY OF ARGUMENT

A.

The imposition of a sales tax on services performed in the taxing state, on property shipped into the taxing state by customers located outside the taxing state, has previously been upheld against an Interstate Commerce Clause challenge in the case of *Department of Treasury v. Ingram-Richardson Manufacturing Company*, 313 U.S. 252, 61 S.Ct. 866, 85 L.Ed. 1313 (1941). *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977) does not apply in this case because this case does not involve an attempt by Arkansas to tax the privilege of carrying on an interstate business operation within Arkansas. Arkansas is seeking to tax only intrastate activity.

B.

State legislatures have wide latitude in adopting tax statutes and tax exemption statutes and the fact that one business is left untaxed and another taxed in order to promote the former or restrict and suppress the later does not violate the Equal Protection Provision of the Fourteenth Amendment.

REASONS FOR DENYING THE WRIT

A.

THE ARKANSAS GROSS RECEIPTS (SALES) TAX, AS APPLIED TO SERVICES PERFORMED WITHIN THE STATE OF ARKANSAS FOR OUT-OF-STATE CUSTOMERS, DOES NOT PLACE A BURDEN ON INTERSTATE COMMERCE IN VIOLATION OF THE INTERSTATE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

The State of Arkansas has imposed its sales tax under Ark. Stat. Ann. §84-1903 (c) (3) (now codified at Ark. Code Ann. §26-52-301 (3) (c) (i)) upon the:

> "Service of alteration, addition, cleaning, refinishing, replacement, and repair of . . . electrical appliances and devices . . . ."

This tax is being imposed on services performed within this State for out-of-state customers.

The United States Supreme Court has upheld the right of a state to impose a tax upon a service even though the service is being performed for a customer in another state. In *Evco v. Jones*, 409 U.S. 91, 93 S.Ct. 349, 34 L.Ed.2d 325 (1972) the Court stated:

> "Our prior cases indicate that a state may tax the proceeds from services performed in the taxing State, even though they are sold to purchasers in another State. Hence, in *Department of Treasury v. Ingram-Richardson Manufacturing Company*, 313 U.S. 252, 61 S.Ct. 866, 85 L.Ed. 1313 the Court upheld a state gross income tax imposed on a taxpayer engaged in the process of enameling metal parts for its customers. We accepted the finding of the Court below that this was a tax on income derived from services, not from sales of finished products, and we found irrelevant the fact that

> the sales were made to out-of-state customers. The tax was validly imposed on the service performed in the taxing State." 409 U.S. at page 93.

In *Department of Treasury v. Ingram-Richardson Manufacturing Company, supra*, the Court upheld an assessment of sales tax against an Indiana business providing the service of coating parts, which belonged to out-of-state customers, with enamel. The enameled parts were subsequently used by the out-of-state customer in manufacturing electrical appliances. The Court stated:

> "The enameling process was an activity performed at respondent's plant in Indiana and the gross receipts therefrom were taxable by Indiana . . . . The fact that the orders for the enameling were obtained by respondent's agents and contracts were executed outside Indiana did not make the enameling process other than an intrastate activity and any the less a proper subject for the application of the taxing statute." 313 U.S. at page 254.

Complete Auto Transit v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), cited by Petitioner, has no application to this case. *Complete Auto Transit* involved a question of:

> " . . . the validity of a state tax for the privilege of carrying on, within a state, certain activities related to a corporation's operation of an interstate business." 430 U.S. at page 274.

This case does not involve any interstate business. All services which Arkansas seeks to tax are intrastate services performed entirely within Arkansas.

B.

THE ARKANSAS GROSS RECEIPTS (SALES) TAX SYSTEM DOES NOT VIOLATE PETITIONER'S CONSTITUTIONAL GUARANTEE OF EQUAL

PROTECTION BY EXEMPTING FROM THE TAX CERTAIN SERVICES PERFORMED IN ARKANSAS FOR OUT-OF-STATE CUSTOMERS WHILE TAXING SIMILAR SERVICES PERFORMED BY PETITIONER IN ARKANSAS ON PROPERTY OWNED BY OUT-OF-STATE CUSTOMERS.

Exemptions from the Arkansas Gross Receipts (Sales) Tax for the service of repairing railroad cars, watches, clocks, or telephone instruments, belonging to out-of-state customers, which are shipped into Arkansas for repair, do not violate the equal protection provisions of the Fourteenth Amendment. In *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959), the Supreme Court reviewed an Ohio statute which provided a tax exemption to:

> "merchandise or agricultural products belonging to a non-resident of this state . . . if held for storage only . . . ."

The Court held that the tax exemption did not deny equal protection of the laws to a resident of Ohio stating:

> ". . . It has long been settled that a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause of the Fourteenth Amendment if any state of facts reasonably can be conceived that would sustain it." 358 U.S. at page 528.

States have wide latitude in adopting tax imposition statutes and exemptions therefrom. In *Carmichael v. Southern Coal and Coke Company*, 301 U.S. 495, 57 S.Ct. 868, 81 L.Ed. 1245 (1937), the Court reviewed an exemption from the Alabama Unemployment Compensation Act for those who employ agricultural labor, domestic servants, seamen, close relatives, and government employees. All others who employed eight or more employees were required to contribute a percentage of an employees wages into the Alabama Unemployment Compensation Fund. The Court stated:

> "It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions." 301 U.S. at page 509.

Arkansas has exempted the repair of railroad equipment, watches, clocks and telephones repaired in the state for out-of-state customers while imposing the tax on all other repairs of property occurring within this State for out-of-state customers. However, an exemption for one industry or group of industries, which is not extended to other industries, does not violate the Fourteenth Amendment. In *Carmichael v. Southern Coal and Coke Company, supra*, the Court stated:

> " . . . Inequalities which result from a singling out of one particular class for taxation or exemption, infringe no constitutional limitations . . . . Like considerations govern exemptions from the operation of a tax imposed on the members of a class. A legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it." 301 U.S. at page 509.

The *Carmichael* Court continued by recognizing that a state may exercise its power to tax to stimulate or encourage particular industries or business or may exercise its taxing power to discourage or suppress businesses which are not favored by the State, saying that:

> "Where the public interest is served one business may be left untaxed and another taxed, in order to promote the one . . . or to restrict or suppress the other." 301 U.S. at page 512.

In *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959), the Court recognized the ability of a state to encourage particular industries to locate within its boundaries through the use of tax exemptions

without violating the Fourteenth Amendment. There the Court stated:

> " . . . it has repeatedly been held and appears to be entirely settled that a statute which encourages the location within the State of needed and useful industries by exempting them, though not also others, from its taxes is not arbitrary and does not violate the Equal Protection Clause of the Fourteenth Amendment." 358 U.S. at page 528.

We do not know the reasons behind the adoption by the Arkansas Legislature of exemptions for services provided to out-of-state customers in repairing railroad equipment, watches, clocks and telephones. However, it is not necessary to understand the legislature's reasoning. As the Court stated in *Allied Stores of Ohio, Inc. v. Bowers, supra*,

> "We cannot assume that state legislative enactments were adopted arbitrarily or without good reason to further some legitimate policy of the State. What were the special reasons, motives or policies of the Ohio Legislature for adopting the questioned proviso we do not know with certainty, nor is it important that we should, *Southwestern Oil Company v. State of Texas*, 217 U.S. 114, 126, 30 S.Ct. 496, 500, 54 L.Ed. 688, for a State legislature need not explicitly declare its purpose. But it is obvious that it may reasonably have been the purpose and policy of the State Legislature, in adopting the proviso, to encourage the construction or leasing and operation of warehouses in Ohio by nonresidents with the attendant benefits to the State's economy, or to stimulate the market for merchandise and agricultural products produced in Ohio by enabling nonresidents to purchase and hold them in the State for storage only, free from taxes, in anticipation of future needs. Other similar purposes reasonably may be conceived. Therefore, we cannot say that the discrimination of the proviso which exempted only the 'merchandise or agricultural products belonging to a nonresident . . . if held in a storage warehouse for

> storage only' was not founded upon a reasonable distinction, or difference in state policy, or that no state of facts reasonably can be conceived to sustain it." 358 U.S. at page 528.-

It is conceivable that the Arkansas Legislature intended to encourage railroads, watch and clock companies or telephone companies as key industries within the State of Arkansas or as key industries in certain economically distressed areas of the State. These industries might also be exempted because they indirectly affect other industries which are important to the overall economic development of the State. Regardless of the actual reasons underlying the adoption of the exemption, a state of facts may be reasonably conceived to sustain the exemptions and the Fourteenth Amendment is not violated by either the exemption or the imposition of tax on other nonexempted services.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should not be issued to review the decision of the Arkansas Supreme Court and the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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